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ARTICLES

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REGRESSION AND INERTIA IN THE RHODESIAN FISCAL STRUCTURE — A COMMENT ON THE 1972 BUDGET

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It is my intention in this paper to comment on the structure of the budget and on Rhodesian fiscal policy in the light of this budgetary structure. I have two basic observations to make. The first is that the 1972 budget is, in structural terms, entirely as was to be expected and it may, in fact, be interpreted as one further budget which has the effect of maintaining a gradual but consistent regressive shift in the fiscal structure. The second is that the structure is not only regressive, but also fairly rigid, and the budgetary principles that have formed the basis of not only this, but also a succession of budgets prior to this, have had the net effect of reducing the impact of fiscal policy on the general level of economic activity. This second observation should not be interpreted as implying a reduction in the influence of the state in the economy but rather as an implication that other, non-fiscal methods, have been increasingly employed in an effort to achieve desired objectives.

Generalisations, by definition, seek to simplify complex situations by reference to dominant characteristics. The test of validity, when applied to generalisations, is not whether simplification obscures detail, but whether this suppression of detail is in fact misleading. My basic thesis is that discussion and analysis of the Rhodesian budget is very often concerned with detail, to the extent that general principles are often overlooked. Further, the details themselves are carefully woven into the general fabric of this structure, and thus an overview is the most efficient way of gaining an insight into the detail.

Before I proceed, however, I would like to limit the field of my analysis, and to justify any limitations.

I have confined myself to the post-Federal era. The interlocking fiscal structures of Federal and Territorial administration cannot be disaggregated effectively for an analysis of this sort. Much of the data I have used in relation to individual tax payers do not extend beyond the 1970 tax year. This is purely a consequence of the availability of processed and published data. In certain instances, where detail in the required form is not available, I have worked with measures that may be quantitatively evaluated in the light of available data, even where these differ slightly from the analytically ideal measures.

However, I do not feel that these limitations provide any grounds for challenging the basic form of my analysis, nor for doubting the general validity of my conclusions.

The Structure of the Budget

Trite observations regarding the inherent regressive or progressive characteristics of types of taxes can be misleading. Although general statements that direct taxes tend to be more progressive than indirect, and sales taxes more regressive than customs and excise duties have some validity, attention must be paid in all cases to the way in which particular taxes are constructed and applied and to the institutional peculiarities of particular circumstances.

Rhodesian policy makers have followed the fairly widespread practice of maintaining a constant and equal balance between amounts raised by direct taxes and those raised indirectly. The details are recorded in Table I, and the 1972 budget has preserved the established 54:46 ratio. The changes that have been taking place within these broad areas have, however, had a profound impact, and have had the effect of shifting the burden of taxation more directly on to taxpayers in the middle and low income groups.

(i) *Indirect taxes*

A discriminatory sales tax can have the effect of placing the burden of taxation more directly on those consuming luxury goods. In Rhodesia, however, the tax is particularly non-discriminatory. Staple foods and paraffin are exempt from the tax, and a higher rate of tax is applicable on only one line of consumer goods — viz. motor vehicles. Since, however, the additional levy on motor vehicles was imposed at the same time as the import duty was withdrawn, the change must be interpreted as a desire to alter the mechanism of collection rather than shift an additional element of the tax burden onto the higher income groups. Services are exempt from sales tax, and since higher income groups would normally consume a larger proportion of income in the form of services than lower income groups, this categorisation of the tax reinforces its regressive impact. On all other goods, the tax absorbs a constant five per cent of expenditure, and the burden of taxation, in proportionate terms, is thus directly a function of the proportion of household incomes spent on taxable consumer items.

The customs and excise levies, on the other hand, have had a tradition of selectivity. In certain instnaces, the potential revenue yield has been of primary importance, but in others, the rate of duty payable has been structured to ensure that the consumption of luxuries, or of goods involving social cost must bear a proportionately higher rate of tax than the consumption of other necessities.

The details of shifts in the structure of indirect taxes must therefore be interpreted in the light of these discriminatory forms of taxes. Table II depicts a steady increase in the percentage contribution of sales tax to total tax from 5,24 per cent in 1964-65 to an estimated 18,14 per cent in the current financial year. Revenue from customs and excise duties, on the other hand, has steadily declined in proportionate terms, from 33,74 to 21,97 per cent over the same period. The decline in customs revenues may be attributed to changes in the pattern of trade and in the nature of imports, but the point made is that the revenues substituted for customs duties have been raised by sales taxes as opposed to excise duties.

The changes introduced in the 1972 budget are not substantial, and, if anything, should be interpreted as evidence of a further shift in the regressive content of indirect taxation. The relief of excise duty on the lower quality of cigarettes was justified purely on the grounds of elasticity of tax revenue, and the alteration is a measure designed to increase total revenue from this source. The duty imposed on opaque beer is direct evidence of indirect taxes being placed on goods consumed by lower income groups, and the burden of taxation has been increased in absolute, as well as relative terms.

(ii) *Direct taxes*

The shifting impact of the burden of direct taxes is far more difficult to isolate and verify, since complete data is only finally available some eighteen months after the end of every tax year, and even then is published in broad aggregates which possibly contain ommissions due to timing of assessments.

There are, however, some clearly discernable trends.

(a) The constant rate of corporate taxation.

Company profits are taxed at constant rates in two respects. Firstly, there is the constancy of the actual tax rate, which does not vary regardless of the level of profit, and secondly there is the observable constancy in this rate over time. There is marked unwillingness to increase the rate of taxation on company profits above the established level of forty per cent, and to apply progressive rates to profits above any primary level. This type of progression is difficult to achieve in practice, but a tax on dividends as personal income may partially achieve the aim. In Rhodesia, dividends do not form a part of individual incomes for purposes of income tax. The net effect is that company taxation is not regressive in its impact on shareholders, but if there is a desire to increase the level of taxation in relation to the level of economic activity, these increases can only be sought from the individual taxpayer with main income from employment.

(b) The level of primary abatements.

The system of abatements was introduced by the Federal administration in the 1963-64 financial year and has been retained by the Rhodesian administration. Prior to that date, all income was "taxable" but subject to a system of rebates. The primary abatements have the effect of placing a "floor" on the level of income that becomes subject to income tax. The levels of abatement, which are $900 for a single taxpayer, $1 920 for a family taxpayer and $288 per child, have remained unchanged since their introduction. The fact that they have remained unchanged in an inflationary situation means that the abatements have been reduced successively in real terms. A calculation based on the published European consumer price index indiates that an abatement of $1 920 in 1964 would have to have been $2 352 in 1972 if the two abatements were to have been comparable in real terms. The fixed level of abatements has meant that the buoyancy of the monetary incomes of individuals has carried an increasing number into the income tax net, even although their real incomes have been markedly more sluggish. In real terms, a larger proportion of middle and low income earners are now subject to income tax.

(c) Changing marginal tax rates.

Marginal tax rates are detailed in Table III, and these figures have been applied in the construction of the graphs in figure I. From the graph, it can be seen that revisions of tax rates since 1964-65 have successively reduced the burden of taxation on the individual income taxpayer in money terms, but that the proportionate relief has been far greater in the higher income groups. It is difficult, in the light of the figures, to give a precise indication of the income level beyond which proportionate relief has been greatest, but generally, and particularly in relation to the 1971 amendments, the greatest relief from these reductions in marginal tax rates will be experienced by taxpayers earning a taxable income in excess of $5 000. A taxable income of $5 000, moreover, converts to an earned income of approximately $8 000, *via* the calculations detailed in table IV.

Thus, despite significant adjustments in the marginal tax rates, relief has really only been felt by taxpayers with incomes in excess of $8 000 per annum, and since relief has been granted to these income earners, and company taxation has remained proportionately unchanged, the tax revenues raised to maintain the proportionate share of direct taxes in the fiscal system must have been raised by increasing the burden on those individual income taxpayers who have not felt the relief of marginal adjustments. These are essentially the middle income earners, with annual incomes of between $3 000 and $8 000. (See table IV).

The data in this respect are unfortunately available only in the form processed in table V. These have been converted in figure II to graphical representation for two selected years (1963-64 and 1970-71). The critical barriers of $3 000 and $8 000 have been marked in. Between these limits, the number of taxpayers becomes critical in the fiscal structure. The barriers form the limits of what can conceptually be regarded as a type of "black box".

The important measures are the comparative rates of the flows entering and leaving the income bracket, not what changes are taking place within it. Provided that the monetary buoyancy of personal incomes carries taxpayers into the no relief "black box" at a greater rate than it carries other taxpayers out of it into the relief areas, then the normal upward shift of incomes within the "box" will ensure bouyant tax revenues. The comparative rates of entry and exit, rather than changes internally, must receive the attention of those responsible for the preparation of the budget. If the trend of inflation carries the bulk of income earners over the upper barrier, and there is no amendment in marginal tax rates to compensate this shift, then the fiscal structure as presently formed, will regain an element of progressiveness, but this type of problem has not yet arisen. The inflow is still favourably aligned, but that alignment is changing (see figure II). It is not unreasonable to expect that the outflow from this "black box" will start to give concern in the years to come, and if my basic thesis is valid, I would expect a shortening of the $4 000 spread of income over which rates remain unchanged in the upper income groups, when the flows become too significant. The current unchanged income tax rates are evidence, then, of the satisfactory alignment of fiscal structures and income distribution patterns as far as the fiscal framework is designed to retain a basically regressive character.

These points I have raised as evidence in support of my first observation, that the 1972 budget is entirely predictable as being in line with the regressive taxation principles laid down in preceding budets.

The second observation is more difficult to justify, and here I must seek evidence in such obscure areas as national economic necessities, Treasury departmental practices, and the attitudes of sitting Parliamentarians.

The Budget as an instrument of economic policy

In general terms, the budget is presented to Parliament annually, and that body is then requested to ratify a series of revenue collections designed either to finance part of or to exceed the level of estimated central government expenditure. Parliamentary endorsement of a budgetary deficit implies that the legislature intends this additional injection of expenditure into the economy during the financial year, and vice versa for a surplus. These basic points appear, however, to have become obscured in general debate on Rhodesia's fiscal affairs. If a planned budgetary deficit is turned into a surplus by buoyant revenue receipts or by restrained expenditure, there is little cause for the annually exhibited enthusiasm and applause that has become a common feature of the Rhodesian Parliament on budget day. If revenue receipts exceeded the intended level then presumably the required revenue could have been raised with a lessening of the tax burden. If the actual level of expenditure falls below the estimated and approved level, then presumably the plans of Government are not be implemented to the full. In either event there is cause for concern rather than applause. If the legislature intends a system of collection and payments different from the approved level, but is operating with caution in estimates, then the current system of Parliamentary endorsement bears no intended relation to reality, and should be dispensed with. I would argue that the principle of budgetary manipulation as an instrument of economic policy has been suspended in Rhodesia as a consequence of Parliament's exhibited preference for balanced budgeting and stability in the liquid alignment of Treasury balances with the Reserve Bank.

Evidence of the preference can be found in Parliamentary Budget Debates over the last few years, but I am more concerned with how Parliametary preference is translated into Treasury practise. The evidence here is more concrete, and I have produced it in Table VI, for the last five years.

In each of these years, actual revenue has exceeded estimated revenue, by an amount of up to $13 033 000 (or 5,69 per cent of the original estimate), and actual expenditure has fallen below estimated expenditure by an amount of up to $6 490 000 (or 2,69 per cent of estimate). The effect of this has been that in three of these years, an intended budgetary deficit has been turned into an actual surplus, and in the remaining two the deficit was smaller than intended. Error in estimates can never be completely avoided, but the constancy of the direction of error in practise in Rhodesia, coupled with the magnitude in successive years, has had the effect of restoring a balance in the budget even where a deviation from that balance has been approved by the legislature. Even where this balance has not been achieved within the strict confines of a particular financial year, balance is restored by the system of carrying forward surpluses into succeeding fiscal years. This departmental practise has the effect of distorting the true intended impact of particular budgets.

The magnitude of a surplus or deficit in a particular budget is usually measured in terms of receipts and expenditures in a particular financial year. A balance carried forward in terms of Treasury accounting procedure may have the illusiory effect of reducing the magnitude of deficit in a particular year or perhaps even of turning a deficit into a surplus. The true imbalance, from the point of view of inflationary or deflationary impact, should be measured net of balances carried forward.

This, however, is not central to my argument. The point of relevance is that these balances have served as the vehicle by which short-term imbalances are corrected over time. The time period has, moreover, been of fairly limited duration. I would argue that the balance arrived at has become a key factor determining the nature of Rhodesian budgets, and that the time period over which imbalance has been tolerated has become extremely short.

This analysis has therefore led up to a general conclusion that the budget has become relatively inert as an instrument of economic policy. The two questions that are automatically posed as a follow-up to the conclusions are — what factors determine the level at which this balance is sought? and — what policy measures have replaced the budget as the primary weapon of government in influencing the level of economic activity?

In many ways the answers are interrelated.

It is not possible to discuss the full range of policy measures that are employed by the government in its role as economic manager and manipulator. A brief reference to state influence in the spheres of transport and communications, in the provision of power, in the agricultural sector through the system of quotas, subsidies and marketing boards, and in the manufacturing sector through import and exchange control and the system of project approval should be sufficient as evidence of the fact that government's responsibilities in the economy extend beyond the simple allocation of tax revenues in the provision of facilities that cannot effectively be provided under a system of free enterprise.

The increased role of government has thus placed certain obligations on government to continue to promote and sustain both the rate and direction of economic growth, and the expenditures that are required in the fulfilment of these obligations have thus limited the freedom of government's choice in deciding on the desirable level of expenditure. The tobacco subsidy and the capital grant to Rhodesia Railways are examples of such unavoidable strategic expenditure.

Under a budgetary system in which the level of "necessary" expenditure is the primary determinant variable, the system of revenue collections assumes secondary importance. This factor may in some measure explain the subjugation of the budget to other policy measures in Rhodesia.

TABLE I

DIRECT AND INDIRECT TAXES

($'000)

Financial Year	*Direct Taxes*	*Indirect Taxes*	*Total Taxes*	*Percentages to Total Taxes*	
				Direct	*Indirect*
1964–65	51 132	46 204	97 336	52,53	47,47
1965–66	57 262	44 776	102 038	56,12	43,88
1966–67	61 992	46 420	108 412	57,18	42,82
1967–68	61 636	52 752	114 388	53,88	46,12
1968–69	74 820	55 101	129 921	57,59	42,41
1969–70	78 314	67 661	145 975	53,65	46,35
1970–71	84 001	76 766	160 767	52,25	47,75
1971–72	104 467	86 342	190 809	54,75	45,25
1972–73*	123 750	96 755	220 505	56,12	43,88

*Estimated

TABLE II
INDIRECT TAXES
($'000)

Financial Year	*Customs & Excise Duties*	*Sales Tax*	*Percentage of Total Taxes*	
			Customs & Excise	*Sales*
1964–65	32 842	5 100	33,74	5,24
1965–66	30 568	5 322	29,96	5,22
1966–67	27 978	9 906	25,81	9,14
1967–68	31 790	11 496	27,79	10,05
1968–69	31 661	13 286	24,37	10,23
1969–70	34 601	21 960	23,70	15,04
1970–71	40 397	28 938	25,13	18,00
1971–72	43 446	34 022	22,77	17,83
1972–73*	48 450	40 000	21,97	18,14

*Estimated

TABLE III
MARGINAL INCOME TAX RATES, AND ADJUSTMENTS

INDIVIDUALS		*COMPANIES*	*SUPERTAX*	
Taxable Income	*Tax Rate* (per £)	*Tax Rate* (per £)	*Super-taxable Income*	*Tax Rate* (per £)
A.1964-65				
First £300	2/3d.	7/3d.	First £1000	3/0d.
Second ,,	3/6d.		Balance	4/3d.
Third ,,	4/9d.			
Fourth ,,	6/0d.			
Balance	7/3d.			
B.1965-66				
As above		As above	First £1000	1/6d.
			Second £1000	3/0d.
			Balance	4/6d.
C.1968-69				
As above		Surcharge 10%	As above	
D.1969-70				
First £500	2/0		Abolished	
Second ,,	3/0			
Third ,,	4/0			
Fourth ,,	5/0			
Fifth ,,	6/0			
Sixth ,,	7/0			
Balance	8/0	8/0		

E.1971-72	(per $)
First $1000	10c
Second „	15c
Third „	20c
Next $4000	25c
„ „	30c
„ „	35c
Balance	40c

TABLE IV

TAXABLE INCOME AND EARNED INCOME EQUIVALENTS

These calculations are based on abatements of a family taxpayer, with two children.

		($)
(i)	Primary abatement	1 920
	2 children	576
	Medical aid (say)	54
	Pension contributions (5% pre-tax salary)	150
	Other deductable insurances (say)	100
		$2 800

Thus, this type of family will not pay income tax if family income is below $2 800 per annum.

(ii)	Primary abatement	1 920
	2 children	576
	Medical aid (say)	104
	Pension contributions	400
	Other deductable insurances (say)	100
	Taxable income	5 000
		$8 100

Thus, a family earning $8 100 per annum will pay income tax on $5 000 of that amount.

TABLE V

NUMBER OF INDIVIDUAL INCOME TAX PAYERS BY INCOME GROUP

Income Year Ended 31st March	INCOME GROUP							
	$1 to 3 000	3 001 to 5 000	5 001 to 6 000	6 001 to 8 000	8 001 to 10 000	10 001 to 12 000	12 001 to 14 000	14 001 and over
1964	29 113	24 421	4 037	3 044	1 024	424	218	365
1965	26 996	24 410	4 675	3 322	1 065	422	198	391
1966	25 879	25 000	5 519	4 237	1 410	550	——643——	
1967	32 168	26 067	5 826	4 084	1 347	511	——658——	
1968	25 092	27 106	6 698	5 007	1 645	617	296	523
*1969	25 235	28 139	7 545	3 781*	2 049	1 828	672	911
°1970	24 987	28 593	8 821	7 513	2 791	1 118	541	990

**Statistics likely to contain significant error due to confusion in classification.*

°*Excludes assessments made during the year* 1971-72 *for income earned in this tax year.*

TABLE VI.

ESTIMATED AND ACTUAL INCOME AND EXPENDITURE: REVENUE ACCOUNT

	INCOME ($'000)			EXPENDITURE ($'000)		
Year	*Estimated*	*Actual*	*Percentage Error*	*Estimated*	*Actual*	*Percentage Error*
1967-68	152 276	165 194	7,82	173 002	168 121	2,90
1968-69	179 500	184 042	2,47	191 684	187 999	1,96
1969-70	198 470	203 882	2,65	207 536	201 911	2,79
1970-71	206 675	213 413	3,16	219 655	213 846	2,72
1971-72	229 060	242 093	5,38	241 222	234 732	2,76

The direction of error has been constant. Revenue has been under-estimated and expenditure over-estimated in every year. The initial error in estimating expenditure has been reduced in every year by the supplementary estimates approved during the year.

TABLE VII.

SURPLUS AND DEFICIT: INTENTION AND ACTUALITY ($)

Year	*Intended Revenue Account Surplus*	*Actual Revenue Account Surplus*
1967-68	—10 480 200	—2 926 888
1968-69	—9 543 984	—3 957 394
1969—70	—5 476 766	+1 971 347
1970-71	—9 040 120	+ 433 324
1971-72	—7 435 308	+ 7 360 473

Note: The values here have been calculated net of any transfer carried forward from previous financial years.

General Sources

1. FINANCIAL STATEMENTS AND BUDGET STATEMENTS. *Annual.* CSR 19-1964, CSR 30-1965, CSR 39-1966, CSR 36-1967, CSR 34-1968, CSR 35-1969, Cmd. R.R. 24-1970, Cmd. R.R. 42-1971, Cmd. R.R. 40-1972. Government Printer, Salisbury.

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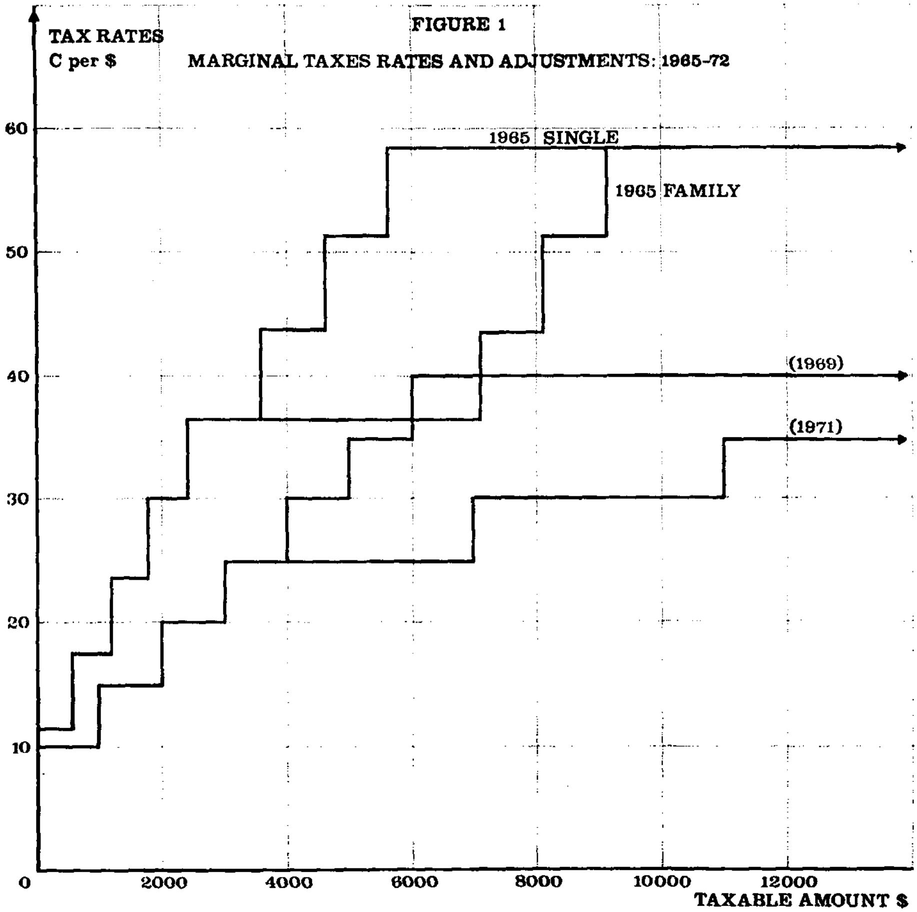

NOTE:- The supertax system (1965) operated above an abatement of $450 and $900 for single persons and family taxpayers respectively. The equation to taxable amount for purposes of graphical representation here, has been achieved by deducting the primary abatements on income tax from these abatements before recording the marginal impact of supertax.

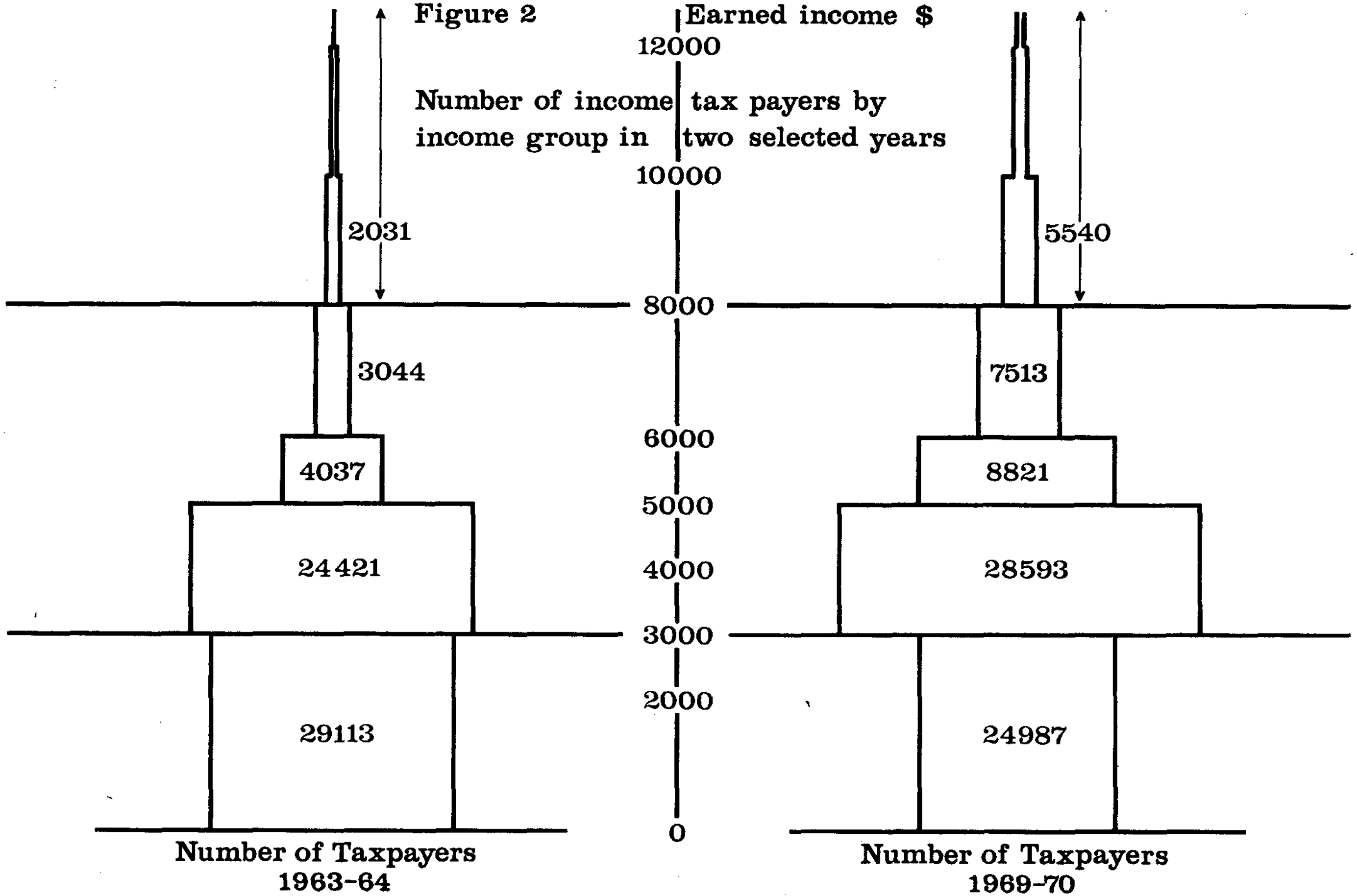

Figure 2

Number of income tax payers by income group in two selected years